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Deregulation: How Far Should It Go?

GEORGE W. WILSON*

All business enterprises are regulated to a greater or lesser extent in the sense that they are subject to constraints of varying kinds that either induce or compel actions which would not otherwise be taken or which would not be taken to the same extent. Such a general level of abstraction, however, is not amenable to meaningful interpretation and analysis. I will therefore confine my remarks to those sets of privately owned and operated enterprises that are subject to economic regulation by commission.

Our broad topic of discussion assumes that there is need for a theory as to when and to what extent deregulation should be carried out. A second component of the question involves the distinction—if such exists—between theories of regulation and theories of deregulation. I turn to the first question in the first section of this paper.

THE POSSIBILITY OF A THEORY OF REGULATION

There exists at the moment no sensible theory of regulation at all, if by a theory is meant a nontautological, rational explanation of existing phenomena, even if we confine ourselves to the issue of commission-type regulation. In a predominantly free enterprise or market economy, we usually study commission regulation, regulation by a special agency of a group of privately owned and operated firms. The agency or commission is usually granted broad powers over specific aspects of the firms so regulated (such as prices, price structure, accounting procedures, mergers, entry, financial arrangements, and so on). Thus, I mean by regulation (and deregulation) powers conferred upon (or taken away from) separately identifiable commissions or agencies with detailed powers to prescribe business practices for a particular set of privately owned and operated firms. Given this conception, a theory explaining when and why particular firms have been subjected to this form of economic regulation rather than left to the general regulation

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of the antitrust laws and competitive forces is either an incredibly complicated exercise or necessarily becomes tautological. It is a complicated and possibly meaningless exercise because:

(a) From American experience a wide variety of industries in terms of structure, performance, and other variables have in fact been regulated by commissions—from trucking to electric power and telephones. Thus, there has been no common economic denominator underlying commission-type regulation and ever since *Nebbia* such commonality is no longer legally relevant.

(b) Some commission regulated industries have sought economic regulation while others have not. There is much ambiguity on this point. Many now believe that the railroads, for example, because of the periodic breakdown of their privately-operated cartels, actively sought the creation of the Interstate Commerce Commission. The traditional view, on the contrary, holds that regulation was thrust upon the railroads as a punishment for abuses of economic power. There is indeed a great variation in the extent to which particular industries now regulated by commission actively sought or fought it. A theory of regulation would need to sort out the historical evidence to determine which is the correct interpretation—no easy task in itself. For instance, in the trucking industry we are advised that regulation was favored by the larger trucking enterprises as well as the railroads and the Interstate Commerce Commission itself, but for the industry as a whole the picture is unclear. Thus, there appears in general to be a wide variation among presently regulated industries in terms of the original sources of and incentives toward regulation and the extent to which the now regulated firms sought to mold the legislation and its subsequent interpretation and enforcement.

(c) Commission regulated industries were subjected to controls at different times, when different overall economic conditions prevailed—the railroads in 1887, electricity and gas in 1905, telephone and telegraph in 1910, trucks and airlines in the mid-1930's, and so on. And, since the overall political conditions and varying legal interpretations, as well as economic conditions, had a great deal to do with both the incidence of regulation and its nature, it is clear that these factors would have to be considered as variables in any theory purporting to explain commission-type regulation. The 1930's, for example, was a period in which society began to question the efficacy of competition as a regulator of business. There was a strong push for "codes of fair competition" under the NRA. In such a milieu, it was easier to justify economic regulation of even competitive industries such as trucking. Similar moods

tend not to have prevailed in earlier or subsequent eras throughout the nation as a whole.

(d) Some commission regulated industries were to be restricted in their pricing and other behavior, while others were to be promoted—for example, the air transport industry. Some of the industries were directly subsidized, such as the shipping industry, and others were not.

I submit, therefore, given this enormous variety of circumstances that a theory with a certain amount of predictive or explanatory power is almost a logical impossibility, and the search for it is probably a meaningless exercise. If we demand of such a theory assertions to the effect that Industry *B* is liable to be subjected to commission-type economic regulation under a specified set of conditions whereas Industry *A* is not, we must very clearly specify the particular conditions. If we are unable to specify, measure, “weight,” and predict these, we will be unable to predict when Industry *A* will in fact be subjected—if at all—to economic regulation. That is, we need to be able to specify a relationship along the following lines:

Economic Regulation of Industry *A* = *f* (structure, practices, and performance of *A*, the state of the industry and the nation, the political power of industry members, vis-à-vis competitors and customers, the relative importance of the industry to the economy and national defense, whether or not Industry *B*, which provides substitute service, is regulated, and other variables).

Not only are many of these variables nonquantifiable but there is no known way for some of them (*e.g.*, political power) even to be ranked between industries. Furthermore, most of the variables change over time in ways that cannot readily be envisioned. In addition, a weighting system would be required for each of the variables which would be inherently subjective unless, of course, some econometric model could be devised to specify the coefficients in some reasonable form and fashion. Finally, we cannot a priori deduce the direction of the relationship for some of the variables. (Does a high degree of political power of the firms in an industry increase the likelihood of regulation or does it increase the likelihood of no regulation at all?) Thus, it seems fair to assert that “continued absence of regulation in some sectors of the economy is the product of historical and political circumstance rather than of any principled policy guiding the activities of American government.”¹

¹ Altshuler, *The Case for Less Transportation Regulation*, at 5, March 5, 1975 (paper delivered at the National Transportation Institute, Chicago).

A theory of regulation in the above sense becomes tautological to the extent that it asserts such things as "regulation occurs when the 'demand for regulation' exceeds the 'supply'" or when "entropy" exceeds the level of "tolerance."² These are tautological because we cannot quantify or even qualitatively rank the variables involved and their components nor can we test the theories empirically. We take the fact of regulation to mean that the benefits *must* have exceeded the costs or that entropy *must* have exceeded tolerance which, without being able to specify the variables involved and their relative weights and ranking, means that industries are regulated because they are regulated. We cannot therefore predict in advance when particular industries will or even may be subjected to any specific form of regulation—commission or otherwise. This is true even when we confine ourselves to strictly economic variables.

Now we have been advised that there are two general theories of regulation. As Posner puts it, one theory "holds that regulation is a device for protecting the public against the adverse effects of monopoly," while the other "holds that regulation is procured by politically effective groups assumed to be composed of the members of the regulated industry itself, for their own protection."³ Neither of these views "explains" much about contemporary economic regulation in the United States. Neither theory—if indeed either one deserves the appellation "theory"—is capable of explaining the origins, regulatory patterns, and practices of the separate regulatory agencies in the United States at present. To search for such a theory of regulation (or deregulation) is in my judgment a waste of time, particularly if one requires of it the type of explanatory power implied by Posner.⁴

The Need for a Theory of Regulation

If the foregoing is accepted as at least plausible, should we then lament the low probability of ever developing a meaningful explanation of the incidence of commission-type regulation of an industry? I think not. Interesting as it may be to offer a plausible interpretation of past economic regulation and possibly even to be able to predict when and where it might occur in the future, the more important aspect of the issue is to examine the conditions under which such regulation may be successful, from the public point of view.⁵ At the same time, a study of

² Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MAN. SCI. 3 (1971).

³ Posner, *Taxation by Regulation*, 2 BELL J. ECON. & MAN. SCI. 22 (1971).

⁴ For example, he complains that neither theory can explain why regulatory commissions encourage "international subsidization." *Id.* at 30.

⁵ Criteria of "success" are noted in section II, *infra*.

the *consequences* of past regulation, even if this failed to result in a theory of regulation, would permit a better assessment of any future or proposed regulatory schemes for particular industries. The combination of knowledge regarding conditions for success and the consequences of past regulatory practices would prove invaluable in analyzing future regulatory, including deregulatory, proposals. In the next section of this paper, I turn to an examination of the conditions for success in this context, to be followed in the third section by an examination of the consequences of past and present regulation.

CONDITIONS FOR SUCCESSFUL REGULATION

There are various criteria for "success" which depend, of course, upon the purpose of, or reasons for, regulation in the first place. A view of regulation as designed to benefit the regulated firms would have different criteria than would a view which stressed the need to restrain anticompetitive practices in the public interest. Since the stated purpose (whether real or not) of virtually all regulatory agencies is to protect the public in one form or another, even in cases where industrial promotion is part of the rationale, I will assume that public interest criteria are most relevant. As an economist, let me employ the distinction between efficiency criteria and social goals. There is no clear-cut distinction between these, for in the final analysis efficiency and economic growth are pursued to accomplish many other objectives relating to equality, defense, health, safety, fulfillment, and the like. Taking the social goals as given, we can argue that successful commission regulation implies an improvement in economic performance, (*i.e.*, a rise in output per unit of input) compared with what would be expected in the absence of such regulation, so long as important social goals are not adversely affected in the process of regulating compared to what would otherwise be anticipated. Indeed, the latter frequently loom large in regulatory behavior even when inconsistent with efficiency. Thus, urban transit fares are held down, often below cost during peak periods, partly to benefit the working poor even though they obviously induce a greater amount of capital devoted to mass transit than would be needed on efficiency grounds. There is nothing wrong with assistance to the poor, but it is at least highly questionable whether this is the most effective way to provide it.

It is worth noting at this point that almost all regulatory commissions have multiple objectives. The ICC, for example, has stated that in any important case it must "consider the economic effects on all

shippers, on towns, cities, ports and regions, on the carriers themselves, and, of course, on the consumers."⁶ All this in addition to the "needs" of commerce, defense, and the postal service! Yet the Commission has never defined its preference function nor specified the relative weights to be accorded to these often conflicting interests.⁷

As a consequence, the Commission is able to "justify" *every* decision regardless of its impact on, say, efficiency in the provision of transport services. Without knowing the relative weights accorded to the many economic and non-economic criteria, it is not possible to judge the Commission's performance objectively in terms of its own goals.

Let us for the moment eschew non-economic criteria or assume these to be best satisfied by policies external to the industry being considered for regulation, or assume that the pursuit of improved economic performance in the industry will not jeopardize non-economic objectives. Stressing economic criteria (*i.e.*, cheapness and plenty or, more formally, the use of least-cost techniques and factor combinations that produce any given volume of output), I have argued elsewhere⁸ that regulation has a high probability of success when the following conditions exist in any industry:

(1) External benefits and costs are large. If there is a wide gap between privately perceived benefits and costs relative to social benefits and costs, and if these cannot, for a variety of economic and non-economic reasons, be brought closer to equality through efficient public pricing (*e.g.*, effluent charges in the case of cars) or taxation (*e.g.*, fuel tax for use of publicly provided right-of-way), then private unregulated decision-making will lead to pricing, output, and investment decisions that are inefficient in the sense of maximizing net social benefits. The wider the gap between social and private costs and benefits, the greater the possibility of successful regulation.

(2) The magnitude of costs that are non-assignable to specific sales units is large. Because of high fixed or joint costs or costs that are non-assignable on a cost-occasioned basis to particular sales units because of a difference between the size of a unit of sales and the minimum feasible unit of output, it is not possible to recover total costs by pricing

⁶ INTERSTATE COMMERCE COMMISSION, *THE REGULATORY ISSUES OF TODAY* 2 (1975).

⁷ I once characterized ICC regulation in terms of a "Grand Benthamite Design" which necessarily fails for the reasons inherent in the failure of Bentham's felicific calculus as well as partial and incomplete Commission jurisdiction. See Wilson, *The Effect of Rate Regulation on Resource Allocation in Transportation*, 54 AM. ECON. REV. 160 (1964).

⁸ *The Logic of Economic Regulation*, in BUSINESS LOGISTICS: POLICIES AND DECISIONS, Ch. 4 (D. McConaugh & C. Clawson eds. 1968).

the sales units on the basis of the costs occasioned by virtue of producing any particular unit. This means that price discrimination of some sort, including an arbitrary allocation of indivisible costs to units of sale, or subsidy, are the only two ways for a private enterprise to break even. Depending upon the nature of the product or service provided, a private firm seeking maximum or even satisfactory profits is liable to discriminate in a fashion inconsistent with other public policy goals. Under these circumstances a regulated pricing structure *can* render price discrimination more consistent with other objectives in a fashion that would not necessarily be more inconsistent with efficiency than a privately established price structure. The greater the magnitude of non-assignable costs, therefore, the greater the possibility of establishing a pricing structure in the public interest with a lesser adverse potential impact upon efficiency.⁹

(3) The industry is inherently "monopolistic" due to economics of scale. This is the traditional justification for imposing price regulation to protect the public from the higher prices and restricted output that ensue from attempts to maximize pecuniary profits under monopoly as compared to competitive conditions.¹⁰

(4) The costs of regulation, including the impact of regulation on efficiency and technological change within the firm or firms regulated are not excessive, or perhaps are favorable to, efficiency and technological change.

Opposite conclusions with respect to the probability of successful regulation hold to the extent that these conditions do not prevail. In general, economic regulation is capable of improving economic performance and/or reducing undesirable side effects from the public viewpoint where the above conditions exist. If only some of these conditions exist, as is likely in most cases, the assessment of the probability of "successful" economic regulation becomes more complex as difficult trade-offs emerge. This does suggest the need for very careful advance appraisal of industry prior to imposition of regulatory restraints.

⁹ Indeed, it can be shown that efficient pricing in a multi-product enterprise subject to a constraint that revenues equal costs or exceed costs by a "fair" or "normal" amount, requires that individual prices systematically deviate from marginal cost on the basis of the reciprocal of the elasticity of demand. Baumol & Bradford, *Optimal Departures from Marginal Cost Pricing*, 60 AM. ECON. REV. 265 (1970). The alternative when $P_i = MC_i$ is, of course, subsidy. One then needs to compare the benefits of the constraint (revenues = costs) with the benefits less the costs of higher taxation due to subsidy.

¹⁰ See J.C. BONBRIGHT, *PRINCIPLES OF PUBLIC UTILITY RATES* (1961); E. CLEMENS, *ECONOMICS AND PUBLIC UTILITIES* (1950).

It should also be noted that several of these conditions are inter-related. For example, the ease and hence the cost of regulation is vastly simplified if only a single firm is involved—though there are troubles aplenty with Ma Bell. In addition, some portion of the non-assignable costs and externalities are directly related to factors rendering the market inherently or “naturally” monopolistic. These conditions are not, however, necessarily interrelated. Regulatory costs are partly dependent on the type of regulation imposed. Cost indivisibilities of various kinds exist in non-monopolistic markets as well. Externalities, as already noted, depend in part upon the attempts of public authorities to price publicly provided facilities economically and to recapture or to internalize external costs. The magnitude of the gap between private and social costs is not something dictated by the inherent nature of the commodity or productive process.

Finally, in this connection, one must admit that measurement of these conditions, or even specifying orders of magnitude, involves substantial guesswork and in the final analysis, especially as regards the last condition, must be judgmental. Nevertheless, the possibility of successful economic regulation by an independent and objective regulatory commission is heavily dependent upon these conditions even if the measurement of many of the variables involved is somewhat judgmental.

CONSEQUENCES OF ECONOMIC REGULATION

The most thoroughly (some would say tediously) explored aspect of economic consequences is a particular form of regulation, namely rate of return regulation.¹¹ Such analyses are confined to a single firm monopoly producing a homogeneous product and assume “effective” regulation as well as static and known cost and demand functions. The general results of such analyses are that (1) compared with unregulated monopoly, output is higher and prices lower; (2) the firm is encouraged to use more capital than is efficient; and (3) under plausible conditions, the suppliers of the regulated monopolist may be induced to conspire and charge higher prices because the rate of return regulated monopolist has less incentive to resist high prices for capital equipment.

Subsequent developments of the so-called A-J effect have modified the original assumptions by introducing such things as regulatory lag, uncertainty, alternative firm objectives beyond simply profit maximiza-

¹¹The literature on this is virtually endless. The initiating analysis emerged almost concurrently in Averch & Johnson, *The Firm Under Regulatory Constraint*, 52 *AM. ECON. REV.* 1052 (1962), and Wellisz, *Regulation of Natural Gas Pipeline Companies: An Economic Analysis*, 71 *J. POL. ECON.* 30 (1963).

tion, and alternative regulatory constraints. Such changes in assumption, not unnaturally, lead to different conclusions including no tendency toward over-capitalization and even *under-capitalization*. The various conclusions emerging from different combinations of assumptions are fully specified elsewhere and for present purposes are not particularly germane.¹²

No comparable theoretical exploration has been made of other than monopoly market structures, nor has the situation regarding dynamics been very carefully examined. Nor have *all* the dimensions of commission regulation under partial jurisdiction been analyzed with any degree of generality. Indeed, given the variety of industries subjected to commission regulation, as well as the differential impact of other aspects of public policy including tariffs, taxes, labor relations, user charges, public investments, subsidies, and the like, it is evident that a *general* theory applicable to all regulated industries would not be very useful. Furthermore, the various regulatory agencies not only have different regulatory powers (including the *extent* of control over firms providing similar services; *e.g.*, the ICC has 100 percent jurisdiction over railroads, 30 percent over motor carriers, and less than 10 percent over inland water carriers, the FPC has jurisdiction only over wholesale interstate sales, the FCC over frequency allocation but not intrastate rates, etc.), but the actual pattern of regulation differs. Some agencies stress rate of return regulation, others concentrate on prices, and some use the operating ratio as a criterion of "fairness"; the relative emphasis on entry and exit control, mergers, accounting procedures, "systematic" integrity, the *structure* of rates, fares and prices, non-efficiency criteria, and so on, differs from agency to agency. There is thus little alternative but to examine the economic consequences on an industry by industry (or commission by commission) basis. While certain comparable results across the regulated industries emerge, the point to stress under present knowledge and circumstances is the diversity noted above. Indeed, if deregulation is to occur, it needs to be justified on a case-by-case basis. The rationale for deregulation of, say, the trucking industry is unlikely to be the same as that for community antenna television (CATV) not only because the "industries" are different but because the regulation also differs; hence the economic consequences and the rationale for reform are likely to differ except in the general sense that such reform is expected to "improve" performance in some sense. Precisely how it would improve performance is necessarily a matter of the specifics involved.

¹² Bailey & Malone, *Resource Allocation and the Regulated Firm* 1 BELL J. ECON. & MAN. SCI. 129 (1970).

In short, just as there is no theory of regulation, there is no theory of deregulation in the sense of explaining, in general, either when deregulation should or will occur or the extent to which it should or will be carried out. Similarly, aside from general statements to the effect that deregulation should be carried out so long as the benefits from deregulation exceed the costs of deregulation, one need not lament the absence of a meaningful theory of deregulation any more than one should lament the lack of a theory of regulation. However, using public interest criteria and emphasizing efficiency, as noted above, one can make judgments concerning the consequences of present regulatory policies and compare these with the probable consequences of various kinds of regulatory reform. In many cases, the judgments will be firmly supported by economic theory as well as by empirical evidence and experience elsewhere. In some cases, however, the probabilities to be attached to the consequences of reform will be very low and at best only informed guesses.

What is required, of course, is an examination of the specific regulatory constraints upon the many aspects of industrial behavior and performance such as profits, prices, capital, mergers, operating authority, entry, exit, and so on. A theory of deregulation, including how far to proceed, would involve modifying those specific regulatory constraints that impede efficiency, assuming this to be the overriding criterion, to the point at which further modification would not yield benefits greater than costs. If the specific constraints are interrelated, all of them may need to be modified concurrently to achieve the preferred outcome. But this is a "theory" only in the most trivial sense and provides no guidance to those concerned with regulatory reform or deregulation.

Let me, therefore, take one of the regulated industries and examine the case for deregulation along the lines suggested above, indicating the extent to which deregulation *should* proceed, not necessarily the extent to which it *will* proceed. I select transportation because regulatory reform has been widely publicized and analyzed ever since President Kennedy's transportation message to Congress on April 5, 1962, specific regulatory reform bills have been submitted to Congress over the past five years (with singular lack of success), and because that happens to be a field in which I have frequently dabbled.

The general rationale underlying regulatory reform in transportation is that the costs of the present pattern of ICC regulation vastly exceed the perceived benefits. Beyond the vague feeling that "something is wrong" in an industry subject to dramatic bankruptcies, enormous

unused capacity, over-all unprofitability, deteriorating service, and rising rates and fares, there is a belief that conditions within the surface land freight transportation industry (rail and truck) have changed to such an extent that the pattern of rail regulation established in 1887 and extended in 1935 to portions of trucking, is no longer relevant; indeed, it may be largely responsible for some of the external manifestations of malaise. While one can, and should, point to many things other than regulation as being responsible for the economic and financial problems of the transportation industry, it is clear that regulation as presently practiced causes many distortions that invariably contribute to the present conditions.

The specific ICC regulatory constraints that have adverse effects are as follows:

(a) The Commission's cost-finding techniques designed to determine rate minima, on the assumption that rates below marginal costs are "unjust," systematically overstate the costs for an efficient carrier in particular markets. Carrier costs are likewise higher than they would be in the absence of regulation because of the common carrier obligations.¹⁸

(b) The impact of Commission regulation on technological change is adverse because of delays in permitting the rate reductions usually associated with more efficient equipment (*e.g.*, unit trains, Big John hopper cars, etc.). This arises because of the Commission's reluctance to permit injury to other regulated firms which may not adopt the innovation and to the desire not to disrupt the existing rate structure and alter the existing market shares among transportation modes.

Technological change and efficient utilization of existing assets is also retarded by the diversion of managerial talent from operating efficiency towards the increasing complexities of complying with the regulatory and legal requirements. This inhibits much active searching for efficiency-enhancing institutional changes or capital investments.

The reduction in competitive pressures that emerges from regulation is believed to reduce efforts at improving efficiency and to contribute to the "quiet life."

¹⁸ This refers to excess capacity costs due to the obligation to serve, and additional costs related to filing of tariffs and schedules, regular reports to the ICC added insurance requirements, higher tax liabilities for similar equipment, the expenses associated with lengthy proceedings, and justification of proposed rate changes. Many of these costs would be either non-existent or much lower in the absence of the present regulatory requirements.

(c) The ICC rate policy contributes to inefficiency by permitting a narrower degree of rate differentiation than is justified by cost differences, by restricting peak/off-peak pricing as well as quantity discounts even when justified by cost differences, and by permitting rate changes at a much slower pace than cost changes. In general, rate regulation as currently practiced systematically violates the economists' efficiency criterion of having prices reflect costs or at least ensuring that price differences reflect cost differences.

(d) Entry control designed to maintain the above rate pattern itself leads to higher costs because of the route, back haul, and commodity restrictions which augment excess capacity and the enormous costs of proceedings with regard to new entrants in any sub-market.¹⁴

All of these consequences emerge from rather straightforward economic analysis. There are substantial analytical and empirical problems associated with each of them and the story is more complicated than indicated above. But this illustrates the kind of analysis or theory needed to derive the consequences of specific regulatory policies. The next step is to attempt some quantification. That is, before tampering with a regulatory pattern that has persisted over a long period of time, one needs to demonstrate that the consequences are significant. Not too many years ago, economists were content with assertions to the effect that most or all of the important transport sub-markets had become "workably competitive" because of the rise of shipper alternatives largely due to the expansion of the highway system and inland waterway improvements. The shippers and communities remaining "captive prey" to the railways appeared to be few in number. Thus, the argument went, assuming ICC regulation was designed to protect the public and not the carriers, such regulation was no longer necessary. Since the Commission is also concerned with the preservation of common carriage (and apparently much else besides!)¹⁵ and since it is difficult to demonstrate the "workability" of competition, this rationale for or theory of deregulation got short shrift.

Subsequently, some economists turned their attention to estimating the "social costs" of economic regulation of transport and to calculations regarding the magnitude of waste or distortion caused by the above-noted consequences. Excluding the impact upon technological change, widely believed to be negative and substantial, the estimated costs appear to be very large for surface transport alone: they amounted to over \$4

¹⁴ A more detailed analysis of the above is contained in Wilson, *Regulation Public Policy, and Efficient Provision of Freight Transportation*, 15 TRANS. J. 5 (1975).

¹⁵ See p. —, *supra*.

billion in 1975. I will refrain from commenting on the derivation of the various estimates. Suffice it to say that most of them used acceptable statistical techniques and propositions consistent with economic theory. While one could obtain different magnitudes using different and equally plausible assumptions and different data sets, the estimates appear to be not unreasonable ball-park figures of the costs to society of present ICC regulation.

The critical problem is to estimate the benefits and attempt to strike a balance. Little work has yet been done in this area. For society as a whole there may be some benefits from retaining a common carrier transport system with its obligations to serve all at published rates without discrimination. There may also be benefits to the economy of preserving a higher degree of rate stability with regulation than without. However, all other potential benefits are essentially transfer benefits from one group to another. For example, the regulated carriers, the Teamsters' Union, the railway operating brotherhoods, some communities and some small shippers may, despite the problems noted above, be better off with economic regulation than without. But such benefits are received from shippers who pay higher rates than would otherwise be necessary, from consumers whose prices are higher because of this, and from taxpayers who are called upon to subsidize various portions of the regulated transport system either directly or indirectly. Such benefits are not *net* for the economy as a whole and unless one is willing to argue that such transfer beneficiaries should receive special treatment at the expense of others, there is no net gain.

Thus the case for deregulation in transport rests on the belief that the preservation of common carriage, a higher degree of rate stability, and the particular income redistributions noted above, are not "worth" over \$4 billion per year and ever greater amounts in the future.

At this point the argument, or theory, gets even fuzzier. Since the consequences of deregulation have not been carefully assessed in terms of which rates for which commodities in which regions will change, either up or down, and by how much, the beneficial outcome rests on the assumption that most transport markets are or would be workably competitive. No one argues that real output of the economy will necessarily rise by \$4 billion were total deregulation to occur, since some degree of excess capacity is necessary in transportation, since some of the costs of litigation and proceedings would merely be shifted from the ICC to the FTC or Antitrust Division of the Department of Justice, and since other aspects of public policy than economic regulation are

involved in the "social costs" as estimated above. In addition, there would or might be transition costs as firms adjust to newly granted freedom of behavior. For the firms involved, especially in trucking, the value of their operating authority would be sharply reduced, especially if greater ease of entry to particular sub-markets were part of the deregulation package and, in a sense, this would be tantamount to taking away some property rights; thus the ATA vigorously fights all proposals for deregulation. To what extent the costs of adjustment would reduce the net benefits of deregulation is unknown. Offsetting these, however, is the stimulus to technological innovation that would probably occur in a workably competitive environment. This is an enormously complex issue involving such things as the determinants of invention, innovation and its diffusion, how regulatory constraints have influenced each, and how each would respond to a reduction or elimination of such constraints. The presumption is that the firms would be more technologically dynamic, and that the delays in introducing a new technique would be shorter. If so, this would increase the net benefits of deregulation.

Finally, the greater flexibility in pricing that would prevail under deregulation would lead to different patterns of discrimination than now exist (which may or may not be desirable), but this would provide a partial alleviation of the problem of downward price inflexibility in the economy as a whole which is widely believed to have contributed to the stagflation dilemma facing the United States during the 1970's.

On grounds such as these, most economists would argue that the specific ICC policies noted above should be relaxed and gradually eliminated over time. Thus we have some proposals and bills in Congress that would, for example, permit rate changes within a certain range (plus or minus seven percent) that would not be subject to ICC suspension or approval, ease the restrictions upon abandonment of service and new entry, require Commission action within a specified period of time (shorter than the usual time involved), reduce the scope of the antitrust immunity for rate bureaus, and so on. In general, the economists' approach involves greater reliance upon competitive forces and a reduction in the extent of detailed economic regulation. There are honest differences of opinion concerning how far one should reduce the Commission's authority on strictly economic grounds. There is, however, a strong belief that many of the non-economic objectives held by the Commission and used to justify uneconomic decisions can be accomplished by direct policies that do not require higher transport costs. Unlike the 19th Century, the Government now has tax and subsidy powers to alleviate any

distress that might follow improved efficiency within transport by way of railway abandonments of unprofitable track, higher rates to some shippers and communities, and so on. In short, the use of a particular industry to accomplish goals external to that industry imposes costs and inefficiencies upon the industry so used. If such goals can be achieved by cheaper and more direct means, then society as a whole is the loser from continued regulation. In industries, such as transport, power, and communications which provide such ubiquitous inputs into virtually all productive processes, the inefficiencies caused or aggravated by regulatory policies appear to be excessive—hence the call for regulatory reform.

Given the uncertainty regarding the specific effects of deregulation, the approach to it has been to emphasize gradualness, largely to ease any transition difficulties and to enable monitoring of the results before proceeding with further deregulation. However, those of us favoring some degree of relaxation of regulatory restraints believe that this will confer net economic benefits upon the American economy. Such a belief is consistent with (a) economic analysis in general, as noted above, (b) experience within this country when the movement of certain agricultural commodities was exempted from economic regulation, and (c) experience in Australia, Canada, the United Kingdom and Sweden when constraints of one form or another were lifted.

ECONOMIC GUIDELINES FOR DEREGULATION

From the foregoing, one can sketch, not a theory, but a set of guidelines to determine how far deregulation should proceed. Using efficiency criteria, we should identify specific regulatory rules and practices whose effect is to raise costs of providing service and/or which serve to impede technological change. We should then seek to quantify such cost increases and compare these with some assessment of "benefits" and the extent to which such benefits may be achieved by less costly techniques, especially regarding those benefits external to the regulated industry itself. None of this will be easy nor, even when well done, free from ambiguity. In addition, the necessity for gradualness, for extending the area of discretionary behavior of the firms initially within relatively narrow bounds for a fixed period of time during which the consequences are carefully observed, is apparent.

This is not a philosophically appealing approach. It involves grubby, microeconomic assessments and measurements commission by commission. Yet to obtain passage of enabling legislation, there is no alternative,

especially where regulation has been in effect a long time,¹⁶ where firms and employee organizations have accommodated themselves rather fully to it and where such firms and organizations have strong political influence. One must make a convincing case that regulatory reform in a particular direction will both improve industry efficiency and not wreak significant harm on the various participants in or beneficiaries of existing regulatory practices.

This is partly responsive to the last question posed for this colloquium: "Does the fact that there is an existing system of regulation pose distinct problems?" The answer clearly is in the affirmative. Regardless of which "theory" of regulation is believed relevant (the "protect the public from monopolistic exploitation" or "protect the firms so regulated from competitive pressures") or some combination of both,¹⁷ the beginning of regulation is liable to be easier than is its reform or reduction. If the first theory is valid, the public is unlikely to be overly concerned at the time regulation is enacted with causing economic loss to previous exploiters and Congress is likely to view such loss as justified retribution for previous excesses or ill-gotten gains. If the second theory is relevant in particular instances, the general public is normally unable to judge the merits of the case and Congress, in effect, has already acquiesced. Not so in cases where, as noted above, regulation has been in effect for many decades. Many of the firms now extant either grew up with such regulation or have never known anything else. They have organized their operations and created institutions in part to accommodate to the fact of regulatory restraint. Any change thus propels firms into the unknown and raises the level of uncertainty, which will be resisted by most of them. In addition, where regulation has conferred certain property values upon the firms or where they have purchased such rights to begin with, any significant change will reduce or even eliminate such values.¹⁸ This not only raises issues of "due process," but will enhance the resistance to change, without adequate compensation, and, less importantly, will lead to reduced tax revenues at all levels of government.

Furthermore, the firms and labor organizations which view themselves as beneficiaries can, and will, alarm third parties concerning the consequences of deregulation. Thus the ATA and the Teamsters have

¹⁶ On the other hand, since regulation did not develop in this way, pressure groups could be organized to push for deregulation in a way analogous to that in which pressure groups led to regulation.

¹⁷ Such as the quid pro quo version which "justifies" some protection of the firms in exchange for accepting certain obligations to serve.

¹⁸ See Tullock, *The Transactional Gains Trap*, 6 BELL J. ECON. & MAN. SCI. 671 (1975).

been partially successful in erroneously raising the specter of serious injury to small communities and small shippers if substantial relaxation of rate and entry control occurs in the trucking industry. There is little such third party input when initiating regulation, although this may be changing with the growth of "public interest" law groups and associations.

As Professor Noll has pointed out, "Most regulatory issues are of deep interest to regulated industries, with a very substantial amount of income . . . riding on the decision. The stake of the general public may in the aggregate be even higher, but it is diffused among a large number of unorganized individuals. . . . The motivation of a single firm to fight an unfavorable regulatory decision is very high, while a regulatory decision unfavorable to the general public is unlikely to generate enough interest to cause a general public interest to be raised."¹⁹

Finally, there is enough uncertainty regarding the economic outcome to give credence to many of the more unlikely consequences regularly adduced by the parties immediately affected. Such allegations that chaos would result, wages would fall, and the like, become part of the rhetoric which all too often succeeds in restraining even the most modest of regulatory reform proposals.

CONCLUSION

A theory of economic regulation or deregulation is probably not especially useful and, depending upon what we expect of such a theory, virtually impossible to develop except in a trivial or tautological sense. I disagree, therefore, with the assertion that there is need for a theory as to when and to what extent deregulation should be carried out. However, using efficiency criteria and employing a pragmatic (regulated) industry by industry approach, one is able to identify particular aspects or details or regulatory constraints that occasion costs and prices greater than any reasonably identifiable benefits. Such constraints should be relaxed gradually or, in some instances, removed totally. If enough of them are identified as being counterproductive in the efficiency sense, it may then be desirable to eliminate commission-type regulation in that industry altogether and leave the industry subject to the antitrust laws.

It is, of course, true that many of the reforms suggested in the various deregulation measures do not require new legislation. Most, if not all, could be implemented by the regulatory commissions themselves. In rate matters, for example, with no solid evidence regarding

¹⁹ R. NOLL, *REFORMING REGULATION* 41 (1971).

demand elasticities and with cost evidence relating to sales units subject to enormous ambiguity, the decision whether to allow any given rate change or portion thereof become essentially judgmental. Thus, a commission could legitimately alter its judgments in these matters to accomplish some of the results implicit in the reform proposals. Similarly, with respect to entry controls, mergers, acquisitions, rate flexibility, etc., the commissions' decisions, being largely judgmental despite voluminous empirical evidence, could readily be made to comply with most of the "reforms" being advocated. In short, legislative reform would be unnecessary, given the wide latitude of commission authority and the evidentiary problems noted above. However, commissions appear to suffer from enormous inertia in these matters for reasons ranging from the desire for a "quiet life" to "sell out" to the industry so regulated to a sincere belief that the existing policies are truly beneficial to the economy, society, and polity as a whole. Perhaps this is why commissions tend to take such a broad view of their mandate and downplay efficiency criteria.

If so, this suggests not only the need for legislation to mandate specific changes but for legislation that more carefully and more narrowly specifies the objectives of regulation. Within the transportation industries, for example, I would strongly endorse legislation that restricts ICC authority *solely* to matters of efficiency within the transport industry itself.

Any negative effects regarding equity, regional imbalance, national defense, particular ports, communities, and the like can be redressed by more straightforward policies whose side effects appear to be less unfavorable than continued malaise within transportation. I suspect that the other regulatory commissions should be urged in one form or another to give far greater weight to efficiency and technological change (*i.e.*, ultimately cheapness and plenty) than has hitherto been the case. In the final analysis, from an economist's point of view, this is the basic justification for deregulation.